No. —

In the Supreme Court of the United States

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GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

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CITATIONS

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The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Tenth Circuit entered in the above case on July 24, 1941.

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 13–22) is unpublished. The opinion of the Circuit Court of Appeals (R. 194–200) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 24, 1941 (R. 200). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Pursuant to a Section 77B plan, corporate assets were transferred to a new company, new bonds and stock distributed to former bondholders, and the stock interests eliminated except for the receipt of stock purchase warrants. The question is whether gain should be recognized upon the taxpayer's exchange of bonds for new bonds and stock. The answer depends upon (1) whether the exchange was tax-free under Section 112 (b) (3) of the Revenue Act of 1936, which in turn depends upon the basic question whether the plan constituted a "reorganization" within the definition of Section 112 (g) (1); or (2) whether the exchange constituted a tax-free transfer under Section 112 (b) (5).

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 8–12.

STATEMENT

Prior to September 2, 1936, the taxpayer owned $44,000 face amount of Colorado Industrial Com-

pany first mortgage 5% bonds due August 1, 1934 (R. 14), which had an adjusted basis of $14,893.25 (R. 9, 37). On September 2, 1936, the bonds were exchanged in a Section 77B proceeding for $17,600 principal amount of income mortgage bonds and 880 shares of stock of a new company, The Colorado Fuel and Iron Corporation (R. 18).

The fair market value of the new securities received in the exchange was $37,884 (R. 36–37), exceeding the cost basis of the old by $22,990.75. The Commissioner determined the deficiencies on the grounds that the profit from this exchange was a taxable gain (R. 9).

The primary facts concerning the Section 77B proceeding were as follows:

The Colorado Industrial Company (hereinafter referred to as Industrial) was a wholly owned subsidiary of The Colorado Fuel and Iron Company (hereafter referred to as Fuel & Iron) (R. 14). The companies in 1934 had outstanding in the hands of the public the following classes of securities (R. 14):

Fuel & Iron	$4,500,000 general mortgage 5% bonds 20,000 shares 8% $100 par value cumulative preferred stock;
Industrial	349,505 shares no par common stock $27,633,000 first mortgage 5% bonds.

Industrial's bonds were unconditionally guaranteed by Fuel & Iron both as to principal and interest. Industrial itself was not engaged in active business and had no assets of substantial value;

virtually all of its properties had been transferred to Fuel & Iron in 1913 (R. 14).

Interest payments due August 1, 1933, on both bond issues were defaulted and receivers were appointed the same day for the properties of Fuel & Iron by the United States District Courts in Colorado and Wyoming. On August 1, 1934, the companies defaulted in the payment of the principal of Industrial's bonds, and each filed a petition under Section 77B of the Bankruptcy Act in the United States District Court for the District of Colorado (R. 14–15).

A plan of reorganization, dated March 1, 1935, was formulated, and after approval by committees for the bondholders and stockholders, was proposed by the debtors pursuant to Section 77B (d) of the Bankruptcy Act (R. 15, 61, 67). The plan provided for the formation of a new company, The Colorado Fuel and Iron Corporation, to which all the assets of the debtor companies would be transferred, subject to the lien of Fuel & Iron's general mortgage bonds (R. 15, 16, 73). The new company (hereafter referred to as Fuel & Iron Corporation) would assume the obligations on the general mortgage bonds, and would issue $11,053,200 of income mortgage bonds and 552,660 shares of common stock which would be distributed in exchange for the Industrial bonds (R. 16). The stockholders of the debtor companies would receive no interest in the new company, but in ex-

change for their stock would be given warrants for the purchase of an aggregate of 315,379 shares of the new stock at $35 per share (R. 16–17).

Pursuant to direction of the court, the plan was submitted to the holders of the Industrial bonds and the Fuel & Iron preferred and common stock for acceptance by the requisite percentage under Section 77B. It was accepted by holders of 75.7% of the bonds, 61.3% of the preferred stock, and 53.2% of the common stock, and thereupon on April 25, 1936, was confirmed by the District Court and duly consummated (R. 15).

Immediately after the consummation of the plan, all of the issued stock of Fuel & Iron Corporation, 552,660 shares, belonged to former holders of the bonds of Industrial (R. 17). No stock was issued to other parties until October 23, 1936, when 37 shares were issued upon the exercise of warrants. Only 465 shares had thus been issued by June 3, 1938 (R. 17).

The warrant agreement provided that the holders of warrants should not have the right to vote or to receive notice as stockholders, and should have no rights whatsoever as stockholders of the new company (R. 16–17). The option price under the warrants was considerably higher than the opening market price for shares of the new companies (R. 17).

The Board of Tax Appeals, rejecting the Commissioner's position, held that the transaction constituted a "reorganization" within the definition

of Section 112 (g) (1) of the Revenue Act of 1936, and that, therefore, gain or loss would not be recognized under Section 112 (b) (3) (R. 22). The court below affirmed the decision of the Board both on this ground and on the further ground that gain or loss would not be recognized under Section 112 (b) (5).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In holding that the taxpayer's securities had been exchanged pursuant to a plan of "reorganization," and that therefore gain would not be recognized.

(2) In holding that Section 112 (b) (5) precluded recognition of gain upon the exchange of the taxpayer's securities.

(3) In failing to hold that the gain realized upon the exchange of the taxpayer's securities should be recognized under Section 112 (a).

(4) In sustaining the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

This case presents the same basic question, whether there is a "reorganization" under the revenue laws, as that involved in *Commissioner* v. *Bondholders Committee, Marlborough Investment Co.*, 118 F. (2d) 511 (C. C. A. 9), and *Commissioner* v. *Palm Springs Holding Corp.*, 119 F. (2d) 846 (C. C. A. 9), pending on the taxpayers' petitions for certiorari, Nos. 128, 129, and 503, respectively; and in *Commissioner* v. *Southwest Consol.*

Corp., 119 F. (2d) 561 (C. C. A. 5), and *Commissioner* v. *Alabama Asphaltic Limestone Co.*, 119 F. (2d) 819 (C. C. A. 5), pending on the Government's petitions, Nos. 286 and 328. The differences are that the problem arises here in connection with a transfer under Section 77B of the Bankruptcy Act, rather than at judicial sale, and that the issue is whether gain or loss may be recognized upon the exchange of securities, rather than the basis for the corporate assets in the hands of the new corporation. Since these differences do not affect the essential question, the considerations set forth in our prior petitions support issuance of the writ here.

A second question is raised by the alternate holding of the court below that Section 112 (b) (5) of the Act precluded recognition of the taxpayer's gain. It is our position that this section is inapplicable to any phase of this transaction.[1] The court's conclusion, however, injects an added complication into the situation which provides a further reason for review.

CONCLUSION

It is therefor respectfully submitted that this petition should be granted.

CHARLES FAHY,
Acting Solicitor General.

SEPTEMBER 1941.

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[1] The application of Section 112 (b) (5) was urged but not determined in the *Southwest Consol.* case, *supra*. See Government's petition for certiorari, p. 9, n. 6.

APPENDIX

Revenue Act of 1936, 49 Stat. 1648:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

* * * * * *

(3) *Stock for Stock on Reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

* * * * *

(5) *Transfer to Corporation Controlled by Transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * * * *

(g) *Definition of Reorganization.*—As used in this section and section 113—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock; of at least persons solely in exchange for stock or 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however affected.

* * * * *

(h) *Definition of Control.*—As used in this section the term "control" means the ownership of stock possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

* * * * *

Bankruptcy Act of July 1, 1898, 30 Stat. 544, as amended by Act of June 7, 1934, 48 Stat. 911, 912:

SEC. 77B. CORPORATE REORGANIZATIONS.—

* * * * *

(b) A plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally, or of any class of

them, secured or unsecured, either through the issuance of new securities of any character or otherwise; (2) may include provisions modifying or altering the rights of stockholders generally, or of any class of them, either through the issuance of new securities of any character or otherwise; * * * (9) shall provide adequate means for the execution of the plan, which may include the transfer of all or any part of the property of the debtor to another corporation or to other corporations, or the consolidation of the properties of the debtor with those of another corporation, or the merger or consolidation of the debtor into or with another corporation or corporations, or the retention of the property by the debtor, the distribution of assets among creditors or any class thereof, the satisfaction or modification of liens, indentures, or other similar instruments, the curing or waiver of defaults, extension of maturity dates of outstanding securities, the change in interest rates and other terms of such securities, the amendment of the charter of the debtor, and the issuance of securities of either the debtor or any such corporation or corporations, for cash, or in exchange for existing securities, or in satisfaction of claims or rights, or for other appropriate purposes; (10) may deal with all or any part of the property of the debtor and may include any other appropriate provisions not inconsistent with this section. * * * (U. S. C., Title 11, Sec. 207.)

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 112 (g)–1. *Purpose and scope of exception of reorganization exchanges.*—*Pur-*

pose: Under the general rule, upon the exchange of property, gain or loss must be accounted for if the new property differs in a material particular, either in kind or in extent, from the old property. The purpose of the reorganization provisions of the Act is to except from the general rule certain specifically described exchanges incident to such readjustments of corporate structures, made in one of the particular ways specified in the Act, as are required by business exigencies, and which effect only a readjustment of continuing interests in property under modified corporate forms. Requisite to a reorganization under the Act are a continuity of the business enterprise under the modified corporate form, and a continuity of interest therein on the part of those persons who were the owners of the enterprise prior to the reorganization. The Act recognizes as a reorganization the change (made in a specified way) from a business enterprise conducted by a single corporation to the same business enterprise conducted by a parent and a subsidiary corporation, but not the creation of a temporary subsidiary as a device for the making of an ordinary dividend. The Act recognizes as a reorganization the amalgamation (occurring in a specified way) of two corporate enterprises under a single corporate structure if there exists among the holders of the stock and securities of either of the old corporations the requisite continuity of interest in the new corporation, but there is not a reorganization if the holders of the stock and securities of the old corporation are merely the holders of short-term notes in the new corporation. In order to exclude transactions not intended to be in-

cluded, the specifications of the reorganization provisions of the law are precise. Both the terms of the specifications and their underlying assumptions and purposes must be satisfied in order to entitle the taxpayer to the benefit of the exception from the general rule. Accordingly under the Act, a short-term purchase money note is not a security of a party to a reorganization, an ordinary dividend is to be treated as an ordinary dividend, and a sale is nevertheless to be treated as a sale, even though the mechanics of a reorganization have been set up.

* * * * *

ART. 112 (g)–2. *Definition of terms.*—The application of the term "reorganization" is to be strictly limited to the specific transaction set forth in section 112 (g) (1). The term does not embrace the mere purchase by one corporation of the properties of another corporation, for it imports a continuity of interest on the part of the transferor or its stockholders in the properties transferred. If the properties are transferred for cash and deferred payment obligations of the transferee evidenced by short-term notes, the transaction is a sale and not an exchange.

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U. S. GOVERNMENT PRINTING OFFICE: 1941